

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**BETTER FISCAL CONTROLS ARE NEEDED AT
THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA,
AND THE UCSB FOUNDATION**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL

P-663

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UNIVERSITY OF CALIFORNIA, SANTA BARBARA,
AND THE UCSB FOUNDATION

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Auditor General

April 7, 1987

P-663

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the need for the University of California, Santa Barbara, to follow university requirements for obtaining construction and consulting contracts, purchasing goods and services for the chancellor's office, and preventing employees from conducting private business on university time. Further, the UCSB foundation should observe accepted lending practices, improve its consulting contracting procedures, and use restricted and endowment funds only as the donors intended.

Respectfully submitted,

Thomas W. Hayes
THOMAS W. HAYES
Auditor General

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SUMMARY

RESULTS IN BRIEF

The University of California, Santa Barbara (UCSB), and the UCSB Foundation (foundation) did not exercise adequate management control to protect their assets. The following conditions resulted from this lack of management control:

- The UCSB paid inflated prices for some construction and maintenance projects and paid for work not performed;
 - An employee embezzled an estimated \$250,000 from the UCSB;
 - The UCSB inappropriately spent at least \$271,240 to repair, remodel, improve and maintain the personal residence of its former chancellor;
 - The UCSB paid salaries to two employees while the employees conducted their private business at three other university campuses;
 - The UCSB paid over \$70,000 for consulting contracts at the Chancellor's Office but has no evidence that the work was actually performed;
 - The foundation lost over \$100,000 by not using accepted lending practices;
 - The foundation did not follow consulting contract requirements of the university; and
 - The foundation inappropriately spent up to \$130,200 of its restricted and endowment funds for loans and \$20,000 for a political contribution.
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BACKGROUND

The UCSB is one of nine campuses of the University of California (university). In June 1986, the university auditor determined

that the UCSB had inappropriately spent \$174,090 for work performed at the chancellor's personal residence. In July 1986, the UCSB chancellor resigned. In December 1986, the Santa Barbara County district attorney filed embezzlement charges against the UCSB employee who was responsible for managing the work at the chancellor's residence, and in March 1987, the UCSB employee pleaded no contest to the embezzlement charges. The district attorney later filed grand theft charges against six individuals. The criminal charges are pending as of March 1987. In March 1987, the district attorney also filed criminal charges against the former chancellor for fraudulently appropriating UCSB property.

PRINCIPAL FINDINGS

The University of California, Santa Barbara, Did Not Follow the University Fiscal Controls

The UCSB did not protect the assets of the university because the UCSB did not follow university requirements. For example, the UCSB did not follow university requirements for the competitive bidding of contracts. As a result, the UCSB paid inflated amounts for construction and maintenance contracts and paid for work never performed. Also, an employee of the UCSB embezzled \$250,000 from the UCSB by receiving cash, goods, and services from contractors.

In addition, the UCSB inappropriately spent at least \$271,240 to repair, remodel, improve, and maintain the personal residence of the former chancellor of the UCSB. The UCSB paid \$171,540 to contractors to work on various parts of the chancellor's house; paid its employees at least \$69,960 to work at the residence; and spent \$29,740 for personal items such as furniture and silver. In addition to expenditures on the chancellor's residence, the UCSB inappropriately spent \$35,930 which includes expenditures for ornamental items and gifts from funds of the Chancellor's Office.

Furthermore, two UCSB employees received consulting fees from three other university campuses at the same time they received their salaries from the UCSB. The employees contracted with the other campuses to perform the same work that they performed for the UCSB.

Finally, the UCSB did not comply with university requirements for consultant contracts. The UCSB could not document that services were received from 10 consultants after the UCSB paid over \$70,000 to these contractors. The UCSB did not have required documents, such as justification for the consultant services and invoices from the consultants to support the payments by the UCSB. Further, none of the contracts were competitively bid.

The UCSB Foundation Lacks Sufficient Fiscal Controls

The foundation lost over \$100,000 by not using accepted lending practices. Specifically, the foundation did not obtain security or obtained inadequate security to protect the foundation's assets before making four loans. Further, the foundation forgave \$20,000 of interest on one loan, retroactively reduced the interest rate charged on another loan by \$8,100, lost \$1,200 by failing to compound interest as required by three of the loan agreements, and failed to assess late penalties totaling \$1,165. Also, the foundation did not pursue delinquent loan payments.

The foundation did not adhere to university requirements when administering consulting contracts totaling over \$184,000. Also, the foundation paid over \$100,000 to four consultants without evidence that the work was performed.

Finally, the foundation inappropriately used up to \$130,200 of restricted and endowment funds for loans to faculty, staff, the former chancellor, and two nonprofit corporations. In addition, the foundation may have violated its articles of incorporation when it contributed \$20,000 to a political campaign committee to support a proposition on the ballot of the November 1986 general election.

CORRECTIVE ACTION

The university has taken action to correct some of the problems discussed in this report. The former UCSB chancellor paid \$80,000 and issued a promissory note to the university for an additional \$94,090 for the inappropriate expenditures on his personal residence. Further, based on the cost identified by the university auditor, the university reimbursed the State for the use of state funds at the residence of the former chancellor. The manager of operations and maintenance at Facilities Management, who pleaded no contest to embezzlement charges, agreed to pay \$100,000 plus interest to the university within 120 days of his release from prison. Finally, the board of regents of the university adopted a policy that requires an audit of the foundation by a nationally recognized firm to ensure compliance with university policies and guidelines.

RECOMMENDATIONS

The university should take specific actions to protect its assets by ensuring that the UCSB follows university requirements for obtaining construction and maintenance contracts and consulting contracts, for purchasing goods and services from funds of the Chancellor's Office, and for preventing employees from conducting private business while employed on university time. The university should recover funds inappropriately paid to the former chancellor, to construction and maintenance contractors, to consultants, and to UCSB employees.

Further, the foundation should take specific actions to protect its assets by observing accepted lending practices, by improving its consulting contracting procedures, and by using restricted and endowment funds as the donors intended.

The university internal audit staff should periodically review the UCSB and the foundation to ensure that they comply with university requirements.

AGENCY COMMENTS

The University of California generally agrees with our recommendations and is taking corrective actions on the deficiencies noted in the report. However, the university disagrees with some of the information in the report and plans to prepare a more detailed response within 60 days.

INTRODUCTION

The University of California (university) is a constitutionally established public trust. It is administered by a board of regents, which has virtually exclusive power to operate, control, and administer the university. The board of regents currently consists of 30 members: 7 regents are ex-officio members, including various constitutional officers of the State; 22 regents are appointed for staggered terms; and one regent is appointed by the regents for a one-year term.

The board of regents appoints the president as chief executive officer of the university. The president is responsible for the administration of the affairs and operations of the university, including the development of policies and procedures. Acting on the recommendations of the president, the board of regents also appoints the chancellors for each campus. The chancellor is the chief campus officer and is responsible for all campus activities, except for specific responsibilities given to the president or held by the regents. The chancellor has administrative authority for the organization and operation of the campus.

The university comprises nine campuses throughout the State, including the University of California, Santa Barbara (UCSB). Approximately 16,300 students are enrolled in undergraduate and graduate programs at the UCSB for the 1986-87 school year. The UCSB

has a budget of approximately \$182 million for fiscal year 1986-87: approximately \$129.4 million from state funds and the remaining \$52.6 million from various other sources, including university funds.

Recently, the Santa Barbara County district attorney filed criminal charges against two UCSB employees. In December 1986, the district attorney filed 11 felony counts of embezzlement against Facilities Management's manager of operations and maintenance. In March 1987, the manager pleaded no contest to embezzling university funds. In March 1987, the district attorney filed criminal charges against the former UCSB chancellor and his wife. The district attorney charged the former chancellor with violating the California Penal Code by fraudulently appropriating UCSB property. The criminal charges are pending against the former chancellor.

The UCSB Foundation

The UCSB Foundation (foundation) is a nonprofit corporation, organized in 1973, to encourage voluntary private gifts, trusts, and bequests for the benefit of the UCSB, its alumni association, alumni affairs, and affiliates of the UCSB. The board of regents recognizes the foundation as the official organization to raise funds to support the UCSB.

The foundation is governed by a board of trustees representing alumni, the community, and the UCSB. The trustees appoint an executive

director to administer the foundation's operations. As of June 30, 1986, the foundation had assets of \$8.9 million, and for fiscal year 1985-86, the foundation spent approximately \$1.6 million for expenses, including \$234,000 for scholarships, awards, fellowships, and grants.

Although the foundation is a separate legal entity, the university and the foundation are interrelated. For example, the foundation must adhere to certain university policies for soliciting gifts on behalf of the UCSB. Also, the executive director of the foundation was the assistant chancellor of the UCSB Development Department. Further, several members of the foundation's board of trustees are employees of the UCSB. Finally, the UCSB works closely with the foundation in soliciting private gifts, trusts, and bequests from the public.

SCOPE AND METHODOLOGY

The purpose of this audit was to determine if specific policies and procedures are effective in protecting the assets of the UCSB and its foundation. We reviewed the operations of the Chancellor's Office, the Development Department, and Facilities Management in the UCSB. Also, we reviewed the foundation's financial transactions in disbursing funds for items such as loans and consultant contracts.

We determined the amount of funds that the university paid for the personal residence of the former chancellor from July 1980 to June 1986. Specifically, we reviewed the 1986 audit report, issued by the university auditor, on the funds spent on the former chancellor's personal residence. Also, we reviewed records at the Chancellor's Office and at Facilities Management, and we reviewed Facilities Management contracts to determine if the bidding requirements of the university were followed. Furthermore, we obtained written statements from Facilities Management employees on the number of hours that they worked at the former chancellor's personal residence. Finally, we interviewed the former chancellor regarding the expenditures for his personal residence.

At the Chancellor's Office, we reviewed a sample of expenditures for equipment, services, supplies, and entertainment that cost more than \$300 from July 1984 to September 1986. In addition, we reviewed all expenditures for gifts, contributions, and entertainment from the chancellor's Administrative Fund for fiscal years 1984-85 and 1985-86. At the Chancellor's Office and the Development Department, we examined consulting contracts for compliance with university requirements and for potential conflicts of interest.

Finally, at the UCSB, we reviewed private consulting activities of Development Department employees while they were employed at the UCSB to determine if they were paid salaries from UCSB while receiving payments as independent consultants at other universities.

At the foundation, we reviewed a sample of expenditures to determine if they complied with the donors' requirements, with the foundation's articles of incorporation, and with requirements of the board of trustees. Also, we reviewed the foundation's lending practices for the ten loans it has made since 1979, totaling \$388,000. Finally, we reviewed the nine consulting contracts the foundation entered into from 1980 through 1986 for compliance with the requirements of the university.

Finally, we cooperated with the Santa Barbara District Attorney's Office in its investigation of alleged criminal activities at the UCSB. Section 10520 of the California Government Code requires the Auditor General's Office to conduct audits in accordance with the "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." These standards require the auditors to notify appropriate law enforcement authorities when the auditors become aware of fraud, abuse, or illegal acts or indications of such acts.

CHAPTER I

THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA, DID NOT ADHERE TO UNIVERSITY FISCAL CONTROLS

The University of California, Santa Barbara (UCSB), did not adhere to University of California (university) controls to protect the assets of the university from embezzlement and poor management. Specifically, the UCSB did not observe university requirements when it contracted for construction and maintenance projects in 1985 and 1986. As a result, the UCSB paid inflated prices for some work or paid for work not performed. In addition, an employee of the UCSB embezzled an estimated \$250,000 from the university, and the UCSB inappropriately spent at least \$271,240 to improve and maintain the personal residence of its former chancellor. Further, the UCSB inappropriately paid \$35,930 for goods and services from funds of the Chancellor's Office. Finally, the UCSB paid over \$70,000 for consulting contracts but has no evidence that the work was actually performed, and two former UCSB employees received consulting fees from other university campuses while receiving their salaries from the UCSB.

THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA, DID NOT FOLLOW CONTRACTING PROCEDURES FOR FACILITIES PROJECTS

Between July 1985 and December 1986, Facilities Management entered into 969 contracts totaling \$11.9 million. However, project managers at Facilities Management did not always follow bidding requirements. Instead, they circumvented competitive bidding

requirements by splitting large projects into smaller contracts, they used informal bidding when competitive bidding was required, they negotiated contracts when bidding was required, and they did not justify the use of negotiated contract procedures.

The university's Facilities Manual specifies bidding requirements for all contracts issued by UCSB's Facilities Management. Contracts for projects over \$50,000 must be competitively bid. To comply with competitive bidding requirements, Facilities Management must advertise projects for at least two consecutive weeks, open and read the bids in public at the time and place stated in the advertisement, and either award the contract to the lowest responsible bidder or reject all bids. For projects that cost between \$25,000 and \$50,000, the university requires informal bidding. For informal bidding, Facilities Management must solicit written, sealed bids from at least three qualified bidders, open and read bids in public at the time and place stated in the invitation, and either award the contract to the lowest responsible bidder or reject all bids. The university's Facilities Manual permits Facilities Management to negotiate contracts for projects costing less than \$25,000 when warranted by specific reasons such as protecting the safety of the general public. When negotiating a contract, the responsible university official must justify the decision not to conduct bidding and must determine that the proposed price is reasonable.

To circumvent bidding requirements, project managers split large projects into smaller projects. Between July 1985 and December 1986, Facilities Management awarded 85 contracts, valued at \$1.8 million, that could have been combined into fewer contracts. Facilities Management negotiated 64 of these contracts, totaling \$1.0 million, that would have required either competitive or informal bidding if they had not been split. The remaining 21 contracts, valued at approximately \$776,000, were informally bid; they represent projects that would have required competitive bidding if they had not been split. For example, Facilities Management awarded 4 contracts, whose negotiated value totaled \$79,856, to the same contractor to repair bathrooms in a residence hall. If the project had not been split, competitive bidding would have been required because the cost exceeded \$50,000.

In addition, Facilities Management split one project--to install tile at one residence hall--into 4 contracts. Each of the 4 contracts was awarded to the same contractor for the same type of work on different floors and in different wings of the same building. The total cost of the project was approximately \$185,000, or \$46,200 for each project. If only one contract had been awarded, competitive bidding would have been required. The project manager stated that Facilities Management split projects into smaller contracts to avoid soliciting bids and delaying the projects. However, according to the project managers, these projects were not urgent and, with sufficient planning, competitive bidding could have been conducted.

In addition, for 30 of the 969 contracts issued between July 1985 and December 1986, Facilities Management hired the contractors for the projects, which totaled more than \$207,000, before contracts between the university and the contractors were signed. The assistant vice chancellor for Facilities Management stated that contract documents were prepared after the work was performed because work was arranged by another campus department, because the work was verbally contracted for, or because the contract was inadvertently not completed.

In addition to reviewing all 969 contracts issued by Facilities Management to determine if projects had been split to avoid competitive or informal bidding, we also reviewed a sample of 163 contracts to determine whether Facilities Management had complied with bidding requirements on contracts for projects that had not been split. We found that Facilities Management had not always met bidding requirements.

For example, Facilities Management awarded 6 contracts, totaling \$326,000, for projects that were informally bid but should have been competitively bid. According to some of the project managers, competitive bidding was not used because the original project estimate was within the range for informal bidding. In addition, Facilities Management awarded three contracts, totaling approximately \$98,000, for projects that were negotiated but should have been informally bid.

In addition, requirements were not always followed for the 86 contracts in our sample of 163, totaling approximately \$793,000, that Facilities Management negotiated. For 23 of these contracts, the required written justification for negotiating the contract was not on file. For 23 of the 63 contracts that did contain written justification, there was not always documentation to support the reasons cited for negotiating the contracts. For example, Facilities Management justified negotiating 15 of the contracts because the contractor was already working at or near the project site. However, for 8 of the 15 contracts, the records contained no evidence that other projects were in process at the same time.

Project managers stated that they awarded contracts without bidding because they were not aware of the bidding requirement or because they were directed to award a contract to a firm specified by the manager of operations and maintenance.

Recent Indictments Involving Facilities Management and Contractors

Bidding reduces the potential for favoritism, fraud, and corruption in the awarding of contracts. Since Facilities Management did not always comply with university bidding requirements, the UCSB paid contractors inflated prices for the work performed on some contracts. Furthermore, the UCSB paid for work that contractors never performed.

In December 1986, the Santa Barbara County district attorney (district attorney) charged the Facilities Management's manager of operations and maintenance with felony embezzlement against the university. He was arrested on December 10, 1986. According to the deputy district attorney, the manager received money, goods, and services totaling an estimated \$250,000 from contractors in exchange for awarding UCSB business to the contractors. The manager inflated the contract prices and issued contracts for work never performed. Also, the manager authorized fraudulent payments to the contractors to reimburse them for the cash, goods, and services that he personally received. In March 1987, the manager pleaded no contest to embezzling university funds; the effect of this plea is the same as that of a guilty plea in criminal proceedings.

In addition, the district attorney charged six individuals at four contracting firms with grand theft against the university. In total, the UCSB paid approximately \$3.8 million to the six firms for contracts between 1981 and 1986; the arrested Facilities Management employee was the project manager for approximately \$1.1 million of these contracts. As of March 18, 1987, criminal charges were pending against the individuals. The district attorney also filed civil lawsuits charging unfair business practices against the four firms and seeks fines up to \$50,000 from each of the contractors. Finally, the district attorney granted immunity from criminal prosecution to individuals from two other firms who stated that they received payments from the UCSB for work not performed or received inflated prices for work performed.

THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA,
INAPPROPRIATELY SPENT FUNDS ON THE PERSONAL
RESIDENCE OF THE FORMER CHANCELLOR

The UCSB inappropriately spent at least \$271,240 to repair, remodel, improve, and maintain the personal residence of the former chancellor. The UCSB used at least \$210,480 in state funds and at least \$60,760 in university funds, including at least \$69,960 for the labor costs of UCSB employees, at least \$29,740 for furnishings and building materials, and at least \$171,540 for contractors.

In March 1987, the district attorney filed criminal charges against the former UCSB chancellor and his wife. The district attorney charged the former chancellor with violating sections of the California Penal Code by fraudulently appropriating UCSB property. The criminal charges are pending against the former chancellor.

The university requires the chancellors of each campus to live in a house provided by the university. However, the board of regents can grant an exception to this requirement and allow a chancellor to live in a house not provided by the university. In 1979, the board of regents authorized the UCSB chancellor to live off-campus in his own residence. To compensate the former chancellor for the expenses of residing in his own residence, the board of regents authorized a housing allowance. Between March 1979 and June 1986, the university paid the former chancellor a housing allowance of \$197,200.

**The University Inappropriately
Spent \$271,310 on the
Former Chancellor's Residence**

In addition to the \$197,200 housing allowance the university paid the chancellor, the UCSB inappropriately paid at least \$271,240 to repair, remodel, improve, and maintain the chancellor's residence. The following table summarizes the sources of the funds used and the amounts paid for specific expenses.

TABLE 1
FUNDS USED FOR EXPENDITURES ON THE PERSONAL RESIDENCE
OF THE FORMER CHANCELLOR
JULY 1980 TO JUNE 1986

	<u>State Funds</u>	<u>University Funds</u>	<u>Total Funds</u>
UCSB Labor	\$ 69,960	\$ 0	\$ 69,960
Furnishings and materials	8,980	20,760	29,740
Contracts	<u>131,540</u>	<u>40,000</u>	<u>171,540</u>
Total Costs	<u>\$210,480</u>	<u>\$60,760</u>	<u>\$271,240</u>

Appendices A, B, and C show, in detail, the expenditures for UCSB labor, furnishings and material, and contracts at the personal residence of the former chancellor.

Inappropriate Use of State Funds

In the budget act for fiscal year 1974-75 (Chapter 375, Statutes of 1974), the Legislature eliminated the use of state funds for executive housing expenditures, including those of chancellors, at the university. According to the university's assistant vice president and director of the budget, there has been no authorization to use state funds since fiscal year 1974-75 for any university housing expenditures, and state law prohibits state funds from being used to purchase house furnishings. The UCSB inappropriately spent \$210,480 of state funds for the personal residence of the former chancellor.

Despite the state law, the UCSB has inappropriately used 23 university employees from Facilities Management to work at the former chancellor's house. Between July 1980 and June 1986, \$69,960 was paid from state funds to 23 employees, who worked 4,045 hours. The number of hours that the employees worked, including painting, maintaining the grounds, carpentry, and plumbing, was based on the written statements of the employees. In addition, since 1980, the UCSB has spent at least \$8,980 in state funds for materials and furnishings for the former chancellor's house, including sofas, chairs, tables, and silver. The UCSB also purchased various construction materials such as a sump pump and bathroom fixtures. Finally, the UCSB paid \$131,540 from state funds to ten contractors for various projects at the former chancellor's house. For example, contractors received \$3,925 to repair the roof and over \$25,000 to replace the flooring in the house.

Inappropriate Use of the University's Funds

The UCSB inappropriately spent \$60,760 of university funds, in addition to the \$197,200 authorized by the board of regents, for furnishings, material, and contracts on the former chancellor's house. According to the president of the university, there is no authorization for the use of any university funds, regardless of source, to improve, maintain, or furnish a personal residence of a chancellor. In addition, policies of the university and the UCSB prohibit the use of university funds for personal purchases. For example, the university's Business and Finance Bulletin (BUS-43) prohibits the use of university assets to purchase goods or services for individuals or for nonuniversity activities. Furthermore, Section P-7700 of the UCSB Policy and Procedures Manual prohibits the use of university-controlled funds for the purchase of or repairs to personal property. Further, Section P-7700 specifically prohibits the purchase of ornamental items.

Since 1980, the UCSB has spent at least \$20,760 in university funds for materials and furnishings for the former chancellor's residence. Materials and furnishings purchased included antique silver candle holders and imported kitchen tiles. Also, the UCSB purchased various garden materials such as trees and plants. The UCSB also paid \$40,000 of university funds to a contractor for work at the former chancellor's house.

Approval for Work at the
Former Chancellor's Residence

The former chancellor was responsible for the expenditures of at least \$140,440 for his personal residence. For example, the former chancellor approved contract work totaling \$51,020 and approved the payment of at least \$19,460 for materials and furnishings. In addition, according to Facilities Management employees, the former chancellor, through his office or his wife, requested that Facilities Management employees perform work at his personal residence. The employees stated that the requests were made either directly to them or through the manager of operations and maintenance. The UCSB labor costs are at least \$69,960 for 4,045 hours of work.

Also, the Chancellor's Office approved the expenditure of \$7,330 for materials and furnishings for the personal residence. Examples of approved expenditures include two temple jars and the restoration of an antique table.

The former chancellor justified the expenditures on his personal residence because of damage caused to his residence and belongings from university entertaining. According to the former chancellor, he had discussed the damage with the UCSB assistant chancellor for budget and administrative operations. The assistant chancellor and the former chancellor agreed to use Facilities Management employees or to make other arrangements to maintain those areas of the residence used for entertaining. However, according to

university policies, the university is not responsible for repairing or replacing personal items damaged or destroyed in the course of university business. Specifically, the Business and Finance Bulletin (Bus-39) states that the university is not liable for any loss or damage to real or personal property not owned or operated by the university, whether or not the loss or damage occurred in the course of employment.

The manager of operations and maintenance at Facilities Management was responsible for \$71,320 of the expenditures at the former chancellor's personal residence. The manager approved \$68,370 for contractors and \$2,950 for furnishings and materials. Also, the manager and the former chancellor were jointly responsible for the expenditure of an additional \$52,150 for contracts.

The University Issued a Release Agreement

In June 1986, the university auditor determined that the former chancellor was responsible for \$174,090 of costs related to construction, improvements, miscellaneous building and maintenance charges, and purchases of personal property.* Using the university

*The university auditor's figure is lower than the amount that the Auditor General's Office determined because the university auditor relied on incorrect estimates provided by the manager of operations and maintenance, who later pleaded no contest to embezzling university funds. Using these estimates, the university auditor determined the cost of the work performed at the personal residence of the former chancellor.

auditor's report as a basis for determining the costs, the university issued an agreement on June 20, 1986. The agreement requires the former chancellor and his wife to pay \$80,000 to the university and to issue to the university a promissory note for the remaining \$94,090 secured by a deed of trust on their personal residence. In exchange, the agreement releases the former chancellor and his wife from all future claims arising out of the costs related to the construction, improvement, and renovation and to the miscellaneous building and maintenance charges at the former chancellor's residence during fiscal years 1983-84, 1984-85, and from July 1, 1985, to April 30, 1986. In addition, the former chancellor and his wife are not liable for costs related to certain personal property purchased for their personal residence between July 1, 1978, and March 31, 1986, that were paid for from the unrestricted Short Term Investment Pool Income. As a result, the release agreement prevents the university from recovering \$72,260 that was inappropriately spent on the personal residence.

The release agreement does not prevent the university from seeking \$17,700 for furnishings, materials, and UCSB labor costs from the former chancellor and his wife because the costs were incurred before the period covered by the release agreement or from a fund source not identified in the release agreement. In addition, the university should recover \$7,190 in personal property identified by university auditors as university property at the former chancellor's personal residence.

Contracts Values Are Questionable

The UCSB hired a consulting firm to review the costs associated with some of the contract work performed at the former chancellor's personal residence by three contractors. The three contractors were hired to remodel the kitchen and laundry area, modify the heating and ventilation system, and replace floors and draperies. The consultants reported that a fair and reasonable price for the improvements performed was \$89,409. However, the university paid the three contractors \$149,701, or \$60,292 more than the consultant determined was fair and reasonable.

As stated previously, in December 1986, the Santa Barbara County district attorney charged the Facilities Management's manager of operations and maintenance, who served as the project manager for most of the work on the former chancellor's personal residence, with 11 felony counts of embezzlement of university property. According to the deputy district attorney, the project manager received money, goods, and services from contractors in exchange for awarding university business to the contractors. In March 1987, the project manager pleaded no contest to embezzling university funds; this plea has the same effect as a guilty plea in a criminal proceeding.

In addition, two of the contractors that the district attorney charged with grand theft performed work at the former chancellor's personal residence. In exchange for immunity from criminal

prosecution, an additional contractor who performed work on the former chancellor's personal residence told the district attorney that he made payments to the project manager and added the amounts to the cost of the work performed at the former chancellor's personal residence.

We are unable to determine the exact value of contract work performed at the former chancellor's personal residence because of the pending criminal charges and the consultant's conclusions on the appropriate cost of the remodeling work. We could not determine the amount of embezzlement by the manager of operations and maintenance and the amount of alleged grand theft by contractors.

THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA,
INAPPROPRIATELY SPENT FUNDS CONTROLLED
BY THE CHANCELLOR'S OFFICE

Between July 1984 and September 1986, the Chancellor's Office spent approximately \$555,000 for services and equipment, entertainment, and supplies. We reviewed expenditures of over \$300 for these items and found that the Chancellor's Office inappropriately spent \$33,400. In addition, we reviewed all expenditures from the chancellor's Administrative Fund and found that the chancellor inappropriately spent \$2,530. The inappropriate expenditures at the Chancellor's Office totaled \$35,930.

The Chancellor Spent Funds
Contrary to University Policies

The UCSB policy prohibits the purchase of ornamental items such as pictures, vases, and draperies from any fund. However, the chancellor inappropriately spent \$15,100 for ornamental items for the chancellor's conference room, including an antique Tibetan wall hanging that cost \$6,400 and raw silk overdraperies that cost \$4,900. In addition, the university requires a vendor invoice and a certification of the receipt of goods or services before payment can be made. However, the accounting officer did not have proper documentation on file to support eight payments totaling approximately \$18,300. For example, the UCSB paid \$750 for a "comprehensive financial, income and estate tax test case" without documentation for the amount owed or evidence that the services were received. In addition, the Accounting Office did not have adequate documentation in its file to support the payment of \$912 to a title insurance company for closing costs on a loan.

Inappropriate Expenditures
From the Administrative Fund

The university provides various university officials with an Administrative Fund, which is intended to supplement expense budgets and provide a source of reimbursement that would not otherwise be available. Through the Administrative Fund, the former chancellor received an allowance of up to \$20,000 in fiscal year 1984-85 and up to

\$21,000 in fiscal year 1985-86. Generally, Administrative Fund expenditures are not limited by university policy on expenditures for travel, entertainment, or gifts. However, the Administrative Fund cannot be used for initial membership fees and for gifts that exceed \$25 per recipient in any one year.

In fiscal year 1984-85, the chancellor inappropriately spent over \$230 (1.2 percent) of the \$20,000 allowance, and in fiscal year 1985-86, the UCSB chancellor inappropriately spent over \$2,300 (11 percent) of the \$21,000 allowance. The chancellor purchased 38 gifts that exceeded the \$25 gift limitation. For example, the chancellor gave a gift of sterling silver, which cost \$326, and he purchased 34 floral gifts that exceeded the \$25 limit per recipient in one year. In addition, the chancellor inappropriately spent \$930 to purchase a lifetime membership for himself and his wife in an airline club.

The UCSB Accounting Office reviewed the documentation for the expenditures from the Administrative Fund, but the Chancellor's Office reviewed the appropriateness of its own expenditures. According to the accounting officer, university policy is unclear on who is responsible for reviewing the appropriateness of the expenditures.

TWO FORMER UNIVERSITY EMPLOYEES CONDUCTED
PRIVATE BUSINESS WHILE BEING PAID BY
THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA

Two former employees of the UCSB Development Department received their salaries from the UCSB while they also received consulting fees from other university campuses. Both employees performed fundraising activities at the UCSB, and they received payments for the same type of work at the other campuses.

The Standing Order 101.3(b) of the board of regents states that no portion of time due the university by an employee may be devoted to private purposes, and no outside employment may interfere with the performance of university duties. Also, the university's administrative guidelines prohibit support groups like the foundation from making payments to employees of the university without the approval of the president or the chancellor. In addition, the university's Business and Finance Bulletin (BUS-34) requires that a consultant disclose any business relationship that exists between the consultant and any university employee.

The Former Director of the Annual Fund

The first employee was director of the Annual Fund in the Development Department from April 1983 to May 1985. His time sheet lists his official hours as 8:00 a.m. to 5:00 p.m. This employee administered the UCSB Annual Fund program, which solicited donations

through telephone contacts with UCSB alumni, parents of students and alumni, and other potential donors. The Development Department would mail a letter to the potential donors, wait a few days, then telephone the donors to solicit a donation to the Annual Fund.

The former director of the UCSB Annual Fund was in a consulting partnership with a person not employed by the university. While the former director was still employed at the UCSB, this partnership contracted with two other campuses of the university. The partnership set up phone-mail solicitation programs at the University of California, San Diego (UCSD) and the University of California, Irvine (UCI). While the one partner was employed by the UCSB Development Department as director of the Annual Fund, the UCSD paid the partnership \$17,500 and the UCI paid it \$26,950. At both campuses, the partnership was responsible for establishing the same type of phone-mail solicitation system that the director managed at the UCSB.

The partnership signed a contract with the UCI Foundation that required the partnership to disclose any conflicts of interest. The contract definition of conflict of interest includes the employment by the university of any member of the contracting organization. The UCI associate director of development knew that one partner was employed by the UCSB; nevertheless, she authorized \$26,950 in payments to the partnership. At the UCSD, the contract did not include a conflict of interest statement. Although the special assistant to the chancellor who signed the contract was advised by the associate vice chancellor

for business affairs to use the standard consulting service contract required by the university, which includes a conflict of interest clause, the director of the Development Office did not use the standard form.

While performing the consulting work at the UCSD, the UCSB employee claimed he was either working for the UCSB or on sick leave. For example, during a two and one-half day period in February 1985, the UCSD campus reimbursed the employee for travel expenses while he conducted his private consulting business at the San Diego campus. Yet, the employee claimed on his UCSB timecard that he was sick for 12 hours and worked the remaining 8 hours on UCSB business. The employee was paid \$404 in salary for the two and one-half days.

Throughout the last six months that the employee worked for the UCSB Development Department, the former assistant chancellor expressed concern over the employee's frequent absences and his involvement in outside consulting work. In a letter dated December 3, 1984, the former assistant chancellor expressed his concern to the employee about the obvious conflict of interest between his full-time, paid position with the UCSB and his consulting contracts and arrangements with other university campuses. The former assistant chancellor was also concerned that the employee had made at least \$450 in personal business calls from his UCSB office phone and that the management of the Annual Fund was suffering because of the employee's absences from the office. However, the former assistant chancellor did

not request assistance from the conflict-of-interest coordinator for the UCSB campus, nor did he take any disciplinary action against the employee.

The Former Director of Deferred Giving

The second employee was the director of the Deferred Giving program in the UCSB Development Department from November 1, 1981, through December 31, 1985. This employee was responsible for soliciting gifts from potential donors and providing financial advice to encourage donors to bequest property or money to the UCSB. In addition to his monthly salary of \$4,333 from the UCSB, this employee received over \$1,700 from the University of California, Berkeley (UCB) for consulting performed in December 1985. These consulting services included soliciting bequests, trusts, and other planned gifts in southern California. The employee also signed a statement with the UCB claiming that he was not an employee at any campus of the university. This statement, dated December 12, 1985, was signed while the consultant was still on the UCSB payroll.

The former assistant chancellor for the Development Department supervised both employees. He also knew that this employee had private consulting businesses while he was employed by the UCSB, but he did not prevent the employee from conducting his private business on university time. For example, in 1984, the former assistant chancellor was aware that the second employee conducted private business on six regular work

days. Although the former assistant chancellor made notes that the employee should be charged vacation time for those days, the employee did not record them as vacation days, and the former assistant chancellor approved the employee's time sheets. The former assistant chancellor stated that he approved the employee's time sheets because he relied on the staff's integrity and because he did not have time to carefully review all time sheets. However, in 1984, the former assistant chancellor and the employee had a consulting partnership. Neither the employee nor the former assistant chancellor reported their partnership on their conflict-of-interest statements. Both individuals stated that they never earned income from their partnership and that they did not believe that their business association constituted a conflict of interest.

THE UNIVERSITY OF CALIFORNIA, SANTA BARBARA,
DID NOT FOLLOW UNIVERSITY REQUIREMENTS
WHEN CONTRACTING WITH CONSULTANTS

Neither the Chancellor's Office nor the former assistant chancellor at the Development Department observed university requirements when they contracted with 26 independent consultants who performed over \$582,000 worth of services. The UCSB accounting officer paid some of the consultants even though supporting documentation, such as invoices and certifications of completion, had not been received. The assistant chancellor for budget and administrative operations in the Chancellor's Office stated that he did not question the chancellor because he is the chief campus official. Without these documents, the

UCSB cannot be sure that the consulting services were necessary, that it obtained services, and that it paid fair and reasonable prices for the services.

The university's Business and Finance Bulletin (BUS-34) requires that consultants be used only when the university determines that the consultant's services are so urgent, special, temporary or highly technical that they cannot be performed economically or satisfactorily by existing university staff. Consultants are expected to be used infrequently, to solve clearly delineated problems, and not to carry out a major portion of a program. The university Business and Finance Bulletin (BUS-43) prohibits contracts for services with spouses of employees unless there has been a specific determination that the services are not available from either commercial sources or the university itself. The university requires all consultants to submit invoices to receive payments for services and requires the UCSB Accounting Office to obtain the invoices and certifications of receipt of services before paying the consultants.

In addition to university requirements, the UCSB Procedures for Use of Independent Consultants, Number 6200 et seq., requires justification for using a consultant. Whenever possible, the UCSB is to solicit proposals from three or more qualified independent consultants when the cost is expected to exceed \$2,500 in any 12-month period. All prospective independent consultants must submit proposals that include a description of their qualifications, an overall

description of the techniques to be used, the total cost of the project, and the name of any university employee who has an interest in the consulting organization.

Consulting Contracts With
the Chancellor's Office

The former chancellor contracted with 21 consultants for over \$431,000 from April 1983 through August 1986. All of the consulting contracts failed to comply with one or more requirements of the university or the UCSB. For example, the Chancellor's Office cannot document that 10 consultants performed the services for which they were hired. Although the UCSB paid the consultants over \$70,000, the Chancellor's Office does not have evidence such as reports, correspondence, or other materials to show that the consultants performed the services. Furthermore, the accounting office does not have certifications that the services were completed. For example, the UCSB paid one consultant over \$19,000 for updating information on the housing market at UCSB and levels of student enrollment. However, the Chancellor's Office has no evidence that the consultant performed the services.

In addition, the UCSB paid approximately \$225,000, without invoices, to 8 consultants. Also, the UCSB paid \$104,000 to 4 consultants working without signed contracts. The UCSB accounting officer made these payments when the chancellor or the assistant chancellor for budget and administrative operations sent a note requesting that the UCSB pay the consultants.

Further, the former chancellor did not have clear descriptions for any of the projects, nor did he have written justifications for using consultants for these projects. The UCSB paid one consultant \$10,000 to advise the chancellor on the "development of university and Community Colleges articulation affairs" without documentation to show what services were provided or why the UCSB needed the services. Neither the former chancellor's executive assistant nor the consultant could explain what these "articulation affairs" were. The consultant said that he was paid primarily to provide a transition in the leadership of a nonprofit organization on campus for which he had been acting director. However, the contract did not specify these services.

In addition, the former chancellor does not have any information on how the consultants were specifically qualified to perform the services for the UCSB. For example, only 3 of the 21 consultants provided evidence that they were qualified to perform the services and provided their intended approach to solve the problems.

Also, the chancellor failed to solicit proposals as required in UCSB policy from other qualified consultants for any of the \$426,000 in contracts written for more than \$2,500 in a 12-month period. For example, the former chancellor signed a contract with a consultant to review the UCSB's administrative structure for four months at a cost of \$35,000. The contract was subsequently amended to increase the cost to \$41,000. However, officials in the Chancellor's Office do not have any documents to show why this consultant was qualified to conduct the

review or how the consultant planned to conduct his review. Furthermore, the former chancellor did not obtain alternate proposals from other qualified consultants.

Further, the UCSB paid a total of over \$55,000 to four independent consultants who were spouses of UCSB employees. Officials in the Chancellor's Office had no documents to show that they had determined that the services they contracted for were not available from commercial sources or from within the university itself. For example, the UCSB paid one consultant, who was the husband of an administrative assistant in the Chancellor's Office, \$9,600 to provide opinions, advice, and recommendations concerning "energy cogeneration and water desalinization possibilities" at the UCSB and to gather information concerning the UCSB's "equipment types, fuel use, and replacement possibilities."

Although university policy prohibits the use of consultants to carry out the major portion of a program, the UCSB contracted with a consultant to carry out a major portion of a program. The UCSB paid this consultant over \$66,600 to provide advice on legislative matters and to serve as liaison between the UCSB and political leaders. The consultant told us that she was responsible for what was essentially the lobbying program for the UCSB. She has since been hired as a special assistant in the Chancellor's Office, and her duties are essentially the same as those she had when she was a consultant.

Consulting Contracts at
the Development Department

The Development Department contracted with five consultants for over \$151,000 in services from March 1983 through June 1986. None of the five consulting contracts complied with all university and UCSB requirements. The Development Department's deficiencies in administering contracts are similar to those of the Chancellor's Office.

The Development Department did not explain why any of the consultant services could not be performed by UCSB staff. In addition, the former assistant chancellor at the Development Department did not ask for proposals from other qualified individuals for four of the five contracts, valued at \$136,265. For example, the department paid one consultant \$68,000 over a 39-month period from March 1983 to June 1986 to develop a strategic fund-raising plan for the UCSB development program. The Development Department awarded the contract but did not explain why the work could not be done by UCSB employees or why this particular consultant was specifically qualified. In addition, the former assistant chancellor in the Development Department did not request proposals from any other consultants but awarded the contract because of his previous close professional association with the consultant. Finally, the Development Department paid the consultant an additional \$11,900 for travel expenses from New England, where he lived, to Santa Barbara, including air fare of over \$8,200 for eight round trips from Boston. The UCSB accounting officer paid the

consultant without supporting evidence to justify the air fare cost of over \$1,000 for each round trip. When the contract was awarded, a Development Department official expressed concern about using a consultant who lived so far from the UCSB campus.

In addition, in November 1984, the Development Department paid a consultant for services when the consultant and the director of the Annual Fund in the Development Department had a potential conflict of interest. When signing the contract with the UCSB to perform the consulting service, the consultant agreed to inform the university if any potential conflict of interest existed. However, the consultant did not inform the UCSB that he and the director were partners in a fund-raising consulting business. The director monitored his partner's contract and also recommended that the UCSB pay the consultant \$1,000. In addition, the Development Department does not have evidence that the consultant completed the contract. Before entering into this \$1,000 contract, the Development Department hired the consultant under two other contracts totaling \$18,500.

Corrective Action

The university has taken action to correct some of the problems discussed in this section. The former UCSB chancellor paid \$80,000 and issued a promissory note for an additional \$94,090 to the university for the inappropriate expenditures on his personal residence. Further, the university reimbursed the State for the

improper use of state funds at the residence of the former chancellor. Finally, the manager at Facilities Management pleaded no contest to embezzlement charges and agreed to pay the university \$100,000, plus interest, within 120 days after his release from prison.

CONCLUSION

The University of California, Santa Barbara, did not observe University of California bidding requirements when Facilities Management contracted for construction and maintenance projects valued at over \$1.8 million between July 1985 and December 1986. As a result, the UCSB paid inflated prices for some work or paid for work not performed on some contracts. In addition, the UCSB inappropriately spent at least \$271,240 to improve and maintain the personal residence of the its former chancellor and inappropriately paid \$35,930 for items from funds of the Chancellor's Office. Also, two former employees of the Development Office received consulting fees from other universities while receiving their salaries from the UCSB. Finally, the UCSB paid over \$70,000 for consulting contracts but has no evidence that the work was actually performed for the Chancellor's Office.

RECOMMENDATIONS

The University of California, Santa Barbara, should take the following actions to ensure that its administration of contracts with Facilities Management complies with the requirements of the University of California:

- Obtain reimbursement from any contractors who overcharged the UCSB for construction and maintenance projects;
- Avoid splitting large projects into smaller contracts to keep from soliciting bids on contracts;
- Obtain bids on all construction and maintenance projects unless they are exempted by university requirements;
- Review negotiated contracts to ensure that the awards are fair and reasonable and comply with university requirements; and
- Periodically audit the operations of Facilities Management to ensure that contract awards comply with university requirements.

The university should take the following actions related to the inappropriate expenditures of funds on the personal residence of the former UCSB chancellor:

- Reimburse the State for the expenditures not already reimbursed;
- Seek reimbursement from the former chancellor for the \$17,700 that was not covered by the release agreement;
- Obtain from the former chancellor all personal property owned by the university;
- Prohibit university personnel from working at the personal residences of university officials without the approval of the board of regents;
- Prohibit using funds from any source for contracts, furnishings, or materials for personal residences of university officials without the approval of the board of regents; and
- Periodically audit Facilities Management to ensure that personnel do not work at the personal residences of university officials without the approval of the board of regents. Also, the Internal Audit Office should

periodically audit Facilities Management to ensure that no funds have been spent on contracts, furnishings, or materials at the personal residences of university officials without the approval of the board of regents.

The UCSB should take the following actions to ensure that only appropriate expenditures are paid from the Chancellor's Office:

- Document all expenditures in accordance with university policies. Specifically, the Chancellor's Office should document every expenditure with the supporting invoices; and
- Direct the Accounting Office to review all requests for payments or reimbursement from the Chancellor's Office to ensure that they comply with university policies. Further, the Accounting Office should reject any request for payment or reimbursement if the requests do not comply with appropriate policies.

The university auditor should periodically audit the Chancellor's Office to ensure that it complies with university policies. Also, the university auditor should annually audit the chancellor's Administrative Fund to ensure that it is used in compliance with university policy. The university auditor

should conduct the reviews of the Chancellor's Office because the UCSB internal audit staff operates under the control of the Chancellor's Office.

The UCSB should take the following actions to ensure that employees do not receive salaries while earning consulting income from the university at the same time:

- Inform employees of the policies of the board of regents and the university on conducting private business while employed by the university;
- Review all conflict-of-interest statements to determine that employees are not engaged in improper activities; and
- Obtain reimbursement from the two former employees for all salaries paid while the employees were engaged in their private consulting businesses.

The UCSB should take the following actions to ensure that consulting contracts comply with university policies:

- Obtain reimbursement from consultants if the UCSB determines that the consultants did not fulfill their contractual duties;

- Develop clearly defined statements that describe the nature of the work to be performed before issuing any consulting contracts. The problem statement should specify why the UCSB cannot perform the work;
- Solicit three or more proposals from qualified consultants when the cost of the consulting contract is expected to exceed \$2,500 in any 12-month period. All consultants' proposals should include a description of their qualifications, an overall description of the techniques to be used, and the total cost of the study;
- Maintain records that document the services performed by consultants;
- Avoid paying any consultant until the consultant submits an invoice to the UCSB for the consulting services and the contracting office issues a certificate of receipt of services;
- Instruct employees on the university's conflict-of-interest policy. The UCSB should annually review its employees' conflict-of-interest statements to ensure that no conflicts exist with consultants; and

- Avoid contracting with consultants who are spouses of the university employees unless the UCSB has determined that the required consulting services are not available from commercial sources or from the university itself.

CHAPTER II

THE UCSB FOUNDATION DID NOT FOLLOW UNIVERSITY FISCAL CONTROLS

The UCSB Foundation (foundation) did not follow accepted lending practices when making \$388,000 in loans. In addition, the foundation did not follow university procedures in awarding contracts or disbursing restricted and endowment funds. As a result, the foundation lost over \$100,000 of principal and interest from loans, paid consultants without evidence that the work was performed, and used restricted and endowment funds for improper purposes.

THE UCSB FOUNDATION DID NOT USE ACCEPTED LENDING PRACTICES

The foundation has administered ten loans totaling \$388,000 to eight individuals and two nonprofit corporations. These loans were made between December 1979 and October 1983. The foundation loaned four faculty members a total of \$97,500 and loaned three staff members a total of over \$96,500. In addition, the foundation loaned a total of over \$185,000 to two organizations: \$137,000 to a nonprofit corporation affiliated with the university and over \$48,800 to another nonprofit corporation. Finally, the foundation improperly loaned \$9,000 to the former chancellor, who was also a member of the foundation's board of trustees.

In administering these ten loans, the foundation did not follow accepted lending practices. For example, the foundation did not always appraise the real property used to secure the loans, did not always record a deed of trust against the property used to secure the loans, did not adhere to the terms of the loan agreements, did not pursue delinquent borrowers, and did not charge interest. As a result, the foundation lost over \$100,000 in principal and interest.

The Foundation Did Not Always
Appraise Property or Record
Deeds of Trust To Secure Loans

Accepted lending practices require that the property used as collateral for a loan be appraised to ensure that it is worth more than the amount loaned. Also, it is the accepted practice of the lender to record a deed of trust on real property at the time the loan is made. By determining the value of the property used as collateral and by recording a deed of trust on the property at the time of loans, the lender is protected if the borrower does not pay the loan.

For nine of the ten loans made by the foundation between 1979 and 1983, real property was used as collateral. However, the foundation did not determine the value of any of this property. Consequently, when one property was sold in 1984, the foundation received less than the balance of the \$48,500 loan. As a result, the foundation was able to obtain only an interest-free note from the borrower. In 1986, the foundation determined that it is doubtful that \$11,466 of the loan will be collected.

In addition, the foundation did not record a deed of trust or did not obtain collateral to secure a loan of \$48,817 to a nonprofit corporation. In 1986, the foundation determined that it is doubtful that \$30,216 of the loan will be collected. Further, for another loan, the foundation was late in recording the deed of trust against the property used to secure the loan. Not recording the deeds of trust at the time a loan is made may allow other entities to secure their claims before the foundation secures its claim, thus jeopardizing the foundation's claim.

In addition, when the foundation loaned \$9,000 to the former chancellor, a trustee of the foundation, it violated Section 5236 of the California Corporations Code. Section 5236 prohibits a nonprofit corporation such as the foundation from lending money to a trustee of the corporation unless certain conditions are met. These conditions include that the loan either be approved by the Attorney General's Office or secured by real property located in the State. Further, Section 5237 of the California Corporations Code states that the trustees who approve these loans are liable to the corporation for any loan made contrary to Section 5236. When the foundation loaned the chancellor \$9,000 in 1982, it did not obtain the approval of the Attorney General's Office, and it did not record the deed of trust until 1985, over 26 months after the loan was made. The chancellor paid the loan in 1986.

The Foundation Did Not
Appropriately Collect Interest

The foundation did not follow accepted lending practices in collecting interest income on five of the ten loans it issued between 1979 and 1983. It did not always require interest rates to be paid, it did not adhere to the rates it had established, or it forgave the payment of interest altogether. As a result, the foundation did not collect over \$58,600 in interest. For six loans, totalling \$155,000, the foundation specified that the unpaid interest would be compounded annually. However, when calculating the amount of interest owed on three of the loans, the foundation did not compound the interest. As a result, the foundation did not collect \$1,200 of interest from the borrowers when the loans were paid. For example, the foundation did not collect over \$1,100 of interest from the loan to the former chancellor that it could have collected if it had compounded unpaid interest annually.

In addition, the foundation forgave interest on one loan even though the terms of the loan specified that interest would be compounded annually. If the foundation had continued to collect interest on the loan, the borrower would owe another \$20,000 to the foundation. The foundation's former executive director justified forgiving the interest because the borrower was having personal and financial problems.

The former executive director of the foundation also reduced the interest rate on a \$29,000 loan to a faculty member retroactive to the original loan date. In December 1984, the interest rate was reduced from 16.75 percent, which was negotiated in April 1981, to 12 percent. By reducing the interest rate, the foundation did not collect over \$16,200 in interest on the loan. The former executive director stated that the foundation reduced the interest rate retroactive to the original loan date because the prevailing interest rates had substantially dropped.

Finally, in 1982, the foundation officials made a \$48,817 interest-free loan without collateral to a nonprofit corporation engaged in charitable and educational activities. If the foundation had charged interest on this loan at the rate of interest that it would have received if it had invested the money in the university's short-term investment pool, it could have earned over \$21,200 in interest.

The Foundation Does Not
Pursue Delinquent Borrowers

The foundation does not charge a penalty to borrowers who are late in making payments. In contrast, the university, which operates a similar loan program, charges a 4 percent penalty on all payments received 15 days or later after the due date. If the foundation charged a late penalty of 4 percent as the university does, the

foundation could have earned an additional \$1,165 from delinquent borrowers. A penalty for late payments encourages borrowers to pay the monthly installment on time.

Furthermore, the foundation did not take actions against delinquent borrowers. For example, for 20 months, the foundation made few attempts to collect payments from the borrower who failed to make payments for over two years. After 20 months, the former executive director requested legal advice on foreclosure on the property the borrower had used as collateral. However, the foundation did not foreclose on the loan, and the borrower sold the property five months later for less than the balance due on the loan. In another case, the foundation has not actively pursued payment of the outstanding loan to one of the nonprofit corporations. The foundation could not provide any evidence that it attempted to collect the loan for over 32 months after the loan was made. In addition, the foundation has not pursued legal action to force the corporation to pay the debt although public documents show that the corporation had over \$9,000 in cash as of December 31, 1985.

THE UCSB FOUNDATION DID NOT
FOLLOW UNIVERSITY REQUIREMENTS
WHEN CONTRACTING WITH CONSULTANTS

The foundation did not adhere to university requirements when awarding contracts to independent consultants. As a result, the foundation cannot be sure that the consulting services were necessary,

that it obtained the services it contracted for, and that it paid fair and reasonable prices for the services it received.

The university's administrative policy governing support groups like the foundation requires them to adhere to either their own specific policies or to university requirements. The assistant director of the foundation stated that it does not have policies or procedures for contracting with consultants. Without its own policies or procedures, the foundation must adhere to university requirements. The university's Business and Finance Bulletin (BUS-34) requires that a consultant's task be so urgent, special, temporary, or highly technical that it cannot be performed by staff; that consultants be used infrequently to solve clearly defined problems; and that consultants not be used to carry out the major portion of a program. The university policy requires that any payments by the foundation to an employee of the university be approved by the president or the chancellor.

The UCSB Policies and Procedures Manual, Section 6200, et seq., requires the foundation to have all prospective consultants submit proposals that include a description of their qualifications, an overall description of the techniques to be used, and the total cost of the work to be undertaken. If the cost is expected to exceed \$2,500 in any 12-month period, the foundation should, whenever possible, solicit proposals from three or more qualified independent consultants. In addition, university procedures require that an authorized

representative of the foundation and the selected consultant sign a contract before any work is performed, that the foundation not pay the consultant before the work is performed, and that the consultant submit an invoice before he or she is paid.

Between 1980 and 1986, the foundation paid over \$184,000 to nine consultants. All of the consulting contracts violated one or more provisions of the university's requirements. For example, although the foundation officials paid four of the nine consultants over \$100,000, the foundation does not have evidence such as reports, correspondence, or other materials to show that the consultants performed the services for which they were hired. The foundation paid \$75,600 to an employee of the athletic department as a sports consultant to contract with radio and television stations for sports shows and to serve on corporate boards. However, except for one contract for \$500, the sports consultant was not successful in contracting for sports shows or serving on corporate boards. The foundation did not provide documentation that either the chancellor or the president approved the payments.

In addition, at the request of the UCSB's assistant chancellor for budget and administrative operations, the foundation paid \$21,000 for a membership in a local country club on behalf of the sports consultant. The assistant vice chancellor for student and community affairs authorized the UCSB to reimburse the foundation for the \$21,000 from the university's discretionary funds. However, the university

prohibits payment of country club membership dues. The UCSB assistant chancellor for budget and administrative operations stated that the country club membership belonged to the university and not to the sports consultant personally. However, university records show that the membership could be maintained only by an individual, not the UCSB.

Furthermore, the foundation did not obtain bids for any of the nine contracts and paid over \$30,000 in what it identified in its accounting records as consulting payments to three individuals who had not signed written agreements. The foundation did not have on file a description of the problems or an explanation of the need for consultants to justify any of the payments made to eight consultants. For example, the foundation officials paid one individual over \$16,000 between April 1984 and June 1985. Also, the foundation did not have any information on the qualifications of five of the consultants. For example, the foundation had no information on one individual who was paid over \$6,000 to assist the former chancellor's wife on social occasions.

The foundation paid over \$114,000 to five consultants before they performed the work. For example, the foundation paid \$32,025 to one consultant to plan a fund-raising campaign. Upon receiving his first \$1,250 payment a month in advance, the consultant wrote a letter to the foundation saying that he was not used to being paid in advance. However, the foundation paid a total of over \$29,950 to the consultant before work was performed.

According to foundation officials, the foundation did not observe university requirements because the officials were not aware that the foundation must follow university requirements. In addition, the assistant chancellor of the UCSB, who was also the executive director of the foundation, did not believe that university policies and procedures were "meant to be taken seriously."

Consulting Fees to the Chancellor

The foundation contracted with the former UCSB chancellor to provide leadership and guidance to the foundation's board of trustees and to make public appearances on behalf of the foundation. However, the foundation did not obtain the required approval from the president to contract with the chancellor for these services, which the chancellor had fulfilled previously without compensation. In fact, the foundation's records show that the purpose of the consultant contract was to provide a means for the chancellor to repay a loan that the foundation could not legally forgive.

In April 1986, the foundation paid the chancellor \$1,398 for three months of consulting. This payment equaled three payments on the loan owed by the chancellor to the foundation. After paying the chancellor for his consulting services, the foundation learned that the payment to the chancellor was improper without the university president's approval and cancelled the consulting contract. The chancellor reimbursed the foundation in full for the consulting fee he received.

THE UCSB FOUNDATION INAPPROPRIATELY
USED RESTRICTED AND ENDOWMENT FUNDS

Because the foundation commingles cash from all sources into one account, it inappropriately used up to \$130,200 of restricted and endowment funds for loans to faculty, staff, the former chancellor, and two nonprofit corporations. Further, the foundation may have violated its articles of incorporation when it improperly contributed \$20,000 to a political campaign committee to support a proposition on the November 1986 election ballot.

When the foundation accepts monetary donations, it is required by its articles of incorporation to restrict the use of the funds to the purposes specified by the donors. When money is donated without restrictions, the board of trustees may restrict the funds to specific uses. Typical uses for restricted funds include scholarships, awards, fellowships, and grants.

The foundation also has endowment funds, which represent monies donated with the requirement that the principal be invested and the income be used for the purpose for which the endowment was created. The board of trustees may also designate funds to function as endowments. As of September 30, 1986, the foundation had a total of \$6.9 million in 140 restricted and endowment funds.

In addition to restrictions on the use of endowment funds established by their donors and the foundation's trustees, the

California Civil Code restricts the use of funds, such as endowments, held in trust. Section 2229 prohibits a trustee from using funds held in trust for any purpose other than that for which the trust was created. Further, Section 2236 makes a trustee liable for the safety of commingled funds held in trust with its other funds.

Funds Used for Inappropriate Purposes

The foundation commingles cash from all sources, including restricted and endowment funds, in one checking account. The foundation does not determine daily what portion of the cash balance is available for payment of unrestricted expenses and what portion is held in trust as restricted or endowment funds. Because foundation officials used this improper accounting procedure, the foundation used its restricted and endowment funds for purposes not intended by the donors of the funds or the board of trustees. From July 1, 1981, through June 30, 1985, the foundation used up to \$130,200 of restricted and endowment funds to make loans to UCSB faculty and staff and to two nonprofit corporations, an inappropriate use of these funds. The former executive director of the foundation stated that he did not know from day to day how much unrestricted cash was available. He considered determining the source of funds for the loans a year-end accounting matter.

In addition, in October 1986, the acting executive director of the foundation used restricted and endowment funds to contribute

\$20,000 to support the passage of Proposition 56 in the State's general election in November 1986. Proposition 56 authorized \$400 million of state general obligation bonds for the construction of educational facilities at colleges and universities.

The foundation made the contribution to Californians for Education--Yes on Proposition 56 Committee. In its statement of organization filed with the Secretary of State, this committee stated that it was primarily formed to support the passage of Proposition 56. The committee used a portion of the contributions received to buy political advertisements.

In response to our request for a legal opinion on the propriety of the donation, the Legislative Counsel stated that the facts suggest that the contribution may have violated the foundation's articles of incorporation. The opinion further stated that, since the contribution was made to an organization formed for the purpose of supporting and influencing voters on a specific initiative measure, there is a strong suggestion that the foundation knew what would be done with the money after it was donated to the committee and that the foundation intended that the money be spent for a purpose other than the dissemination of neutral information.

Because the foundation did not have sufficient assets from unrestricted sources to pay for its unrestricted expenditures, the

foundation used its restricted and endowment funds for loans and a political contribution. Consequently, these funds were not available for scholarships, grants, or awards.

Corrective Action

In March 1987, the board of regents adopted a new policy for auditing university foundations. Specifically, foundations must be audited by a nationally recognized firm of certified public accountants. Also, the auditors must conduct a review of the foundations' compliance with university policies and guidelines.

CONCLUSION

The UCSB Foundation did not exercise adequate management controls to protect its assets and lost over \$100,000 by not using accepted lending practices related to security, interest rates, collections, and late penalties. In addition to using poor lending practices, the foundation did not adhere to university requirements when administering consulting contracts. As a result, the foundation cannot be sure that the consulting services were necessary, that it obtained the services for the money paid, and that it received fair and reasonable prices for the services.

Finally, the foundation inappropriately used restricted and endowment funds for improper purposes and may have violated its articles of incorporation by contributing \$20,000 to a political campaign committee to support legislation.

RECOMMENDATIONS

The university and the board of trustees of the foundation should direct the foundation's executive director to take the following actions to improve the foundation's loan program:

- Prohibit the foundation from making loans to any employee of the university;
- Obtain an appraisal of the value of the collateral for any loan, secure the loan at the time the loan is made, charge interest at a rate that provides a reasonable return on the foundation's funds, calculate interest in accordance with the terms of the loan, assess penalties on any late payments, and pursue any delinquent borrowers through appropriate legal means; and
- Pursue legal action to collect the delinquent loan amount from the nonprofit corporation that owes the foundation \$33,800 as of June 30, 1986.

The university and the board of trustees of the foundation should direct the foundation's executive director to take the following actions to improve the foundation's administration of consulting contracts:

- Seek reimbursement from any consultants that the foundation determines did not fulfill their contractual duties;
- Develop clearly defined problem statements that describe the nature of the work to be performed and how the work will contribute to the objectives of the foundation and the UCSB;
- Solicit three or more proposals from qualified consultants when the cost of the consulting contract is expected to exceed \$2,500 in any 12-month period. All consultants' proposals should include a description of their qualifications, an overall description of the techniques to be used, and the total cost of the contract;
- Use the standard university consulting contract when awarding contracts to consultants;

- Maintain records that show that the consultant performed the services specified in the contract. Further, the foundation should prepare a certificate of receipt of services when the consulting services are completed; and
- Withhold payments to any consultant until the consultant submits invoices for the consulting services. Further, the foundation should not pay any consultant until the foundation issues a certificate of receipt of services.

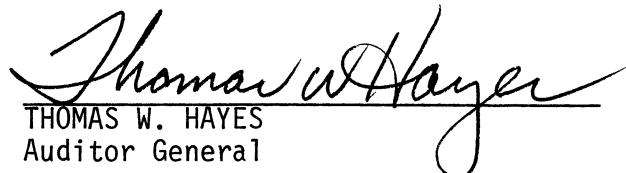
The university and the board of trustees of the foundation should direct the foundation's executive director to take the following actions to ensure that restricted and endowment funds are used for authorized purposes:

- Establish separate agency accounts with the UCSB for each unrestricted, restricted, or endowment fund. Agency accounts would provide the foundation with better control and documentation over its expenditures;
- Avoid making political contributions, which violate the foundation's articles of incorporation; and
- Spend restricted and endowment funds only as the donors intended.

Finally, the UCSB Internal Audit Office should periodically audit the foundation to determine if the foundation is complying with university requirements.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



The signature is handwritten in black ink, appearing to read "Thomas W. Hayes". Below the signature, the name is printed in a smaller, sans-serif font.

THOMAS W. HAYES
Auditor General

Date: April 6, 1987

Staff: Thomas A. Britting, Audit Manager
Dore C. Tanner, CPA
Ann K. Campbell
Wendy T. Rodriguez, CPA
Thomas A. Sachs
Paul W. Apfel
Jeffrey Stevens
Keith K. H. Tsukimura

APPENDIX A

**NUMBER OF HOURS AND LABOR COSTS OF
UCSB FACILITIES MANAGEMENT PERSONNEL
AT THE FORMER CHANCELLOR'S PERSONAL RESIDENCE**

Fiscal Year	Type of Work Performed								Annual Total
	Carpentry	Electrical	Grounds Maintenance	Locksmith	Painting	Plumbing	Utilities		
1980-81 Dollars Hours	\$ 100 6	\$ 0 0	\$ 0 0	\$ 0 0	\$ 0 0	\$ 0 0	\$ 170 14		\$ 270 20
1981-82 Dollars Hours	\$ 750 43	\$ 0 0	\$ 60 7	\$ 0 0	\$ 4,640 259	\$ 1,110 58	\$ 580 35		\$ 7,140 402
1982-83 Dollars Hours	\$ 1,040 59	\$ 0 0	\$ 1,010 87	\$ 0 0	\$ 3,940 217	\$ 780 41	\$ 340 24		\$ 7,110 428
1983-84 Dollars Hours	\$ 5,190 289	\$ 510 29	\$ 2,930 237	\$ 150 8	\$ 660 34	\$ 1,980 105	\$ 1,960 125		\$13,380 827
1984-85 Dollars Hours	\$ 4,100 205	\$1,200 58	\$ 3,480 265	\$450 20	\$ 2,940 141	\$1,480 68	\$1,470 68		\$15,120 825
1985-86 Dollars Hours	\$ 2,740 127	\$1,800 74	\$11,600 863	\$ 0 0	\$ 8,400 378	\$2,400 101	\$ 0 0		\$26,940 1,543
Totals									
Dollars	<u>\$13,920</u>	<u>\$3,510</u>	<u>\$19,080</u>	<u>\$600</u>	<u>\$20,580</u>	<u>\$7,750</u>	<u>\$4,520</u>		<u>\$69,960</u>
Hours	<u>729</u>	<u>161</u>	<u>1,459</u>	<u>28</u>	<u>1,029</u>	<u>373</u>	<u>266</u>		<u>4,045</u>

**DESCRIPTION AND COSTS OF CONTRACTS FOR
REMODELING, REPAIRING, AND RENOVATING THE
FORMER CHANCELLOR'S PERSONAL RESIDENCE**

<u>Date Completed</u>	<u>Project Description</u>	<u>Funds Charged</u>	
		<u>State Funds</u>	<u>University Funds</u>
September 1983	Prepare a study to reduce basement flooding	\$ 445	
September 1983	Repair storm drainage system	6,200	
December 1983	Replace retaining wall	2,875	
September 1984	Repair roof	3,925	
November 1984	Install new flue and insulate	2,686	
December 1984	Design cooling system	774	
January 1985	Trim, prune, and cut trees	3,585	
February 1985	Repair and replace flooring	14,530	
February 1985	Refinish stairs and landings	1,945	
April 1985	Install motorized canvas sun screens	2,090	
August 1985	Replace flooring	10,830	
August 1985	Remove and replace window coverings	13,365	
October 1985	Install cabinets, counters, and appliances	18,634	
November 1985	Repair, replace, and refurbish kitchen	40,595	
December 1985	Modify kitchen and dining room		\$21,465
January 1986	Furnish and install cabinets and appliances		18,535
March 1986	Reline flue and realign ducts	4,290	
March 1986	Install cabinets and appliances	<u>4,771</u>	<u></u>
Total Contracts		<u>\$131,540</u>	<u>\$40,000</u>

**MATERIALS AND FURNISHINGS PURCHASED FOR
THE FORMER CHANCELLOR'S PERSONAL RESIDENCE**

<u>Date of Charges</u>	<u>Materials, Furnishings, and Services</u>	<u>Funds Charged</u>	
		<u>State Funds</u>	<u>University Funds</u>
May 1980	Chippendale desk		\$ 1,060
December 1982	Rug cleaning on site	\$ 565	
March 1983	Two temple jars	210	
November 1983	Plumbing supplies and parts	523	
November 1983	Silver candleholder	2,976	
November 1983	Tiffany silver	2,280	
December 1983	Sofa		1,810
January 1984	Tiffany forks		1,410
February 1984	Table and bar stools		824
March 1984	Chair and ottoman		468
March 1984	Fabric		279
March 1984	Carpets		859
April 1984	Three trees	215	
April 1984	Bed		847
May 1984	Plumbing supplies	243	
July 1984	Restoration of antique table		458
September 1984	Five-drawer chest		1,153
October 1984	Sofa and fabric		2,431
January 1985	Lamp and tables		530
February 1985	Tea table		636
March 1985	Silk taffeta		106
April 1985	Miscellaneous		100
April 1985	Telephones		328
May 1985	Fabric		830
August 1985	Blue toilet	249	
August 1985	Chair, settee, and cocktail table		412
September 1985	Carpet cleaning		152
October 1985	Kitchen tiles		3,452
October 1985	Upholstery work		1,103
October 1985	Repair table top and chairs		525
October 1985	Plants	238	
December 1985	Household expense		60
January 1986	Kitchen work table and stools		397
January 1986	Victorian and rosewood chairs		329
January 1986	Tilt-top table		201
February 1986	Sump pump	669	
February 1986	Plants	212	
April 1986	Fertilization of plants	600	
 Totals		\$8,980	\$20,760

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DAVID PIERPONT GARDNER
President

OFFICE OF THE PRESIDENT
BERKELEY, CALIFORNIA 94720
(415) 642-1441

April 1, 1987

Mr. Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Hayes:

I am responding to your letter of March 26, 1987, transmitting the draft audit report on the University of California, Santa Barbara, and the UCSB Foundation and requesting a preliminary response by April 1. The University is in general agreement with the thrust of the recommendations of the audit report requiring compliance with University policy.

With regard to the Santa Barbara campus, we have taken several actions, including organizational and procedural changes in and increased external audit attention to the Facilities Management department, strengthening campus accounting and fiscal controls and increasing emphasis on adherence to established University and campus policies applicable to these areas.

The University is in agreement that the UCSB Foundation should be in compliance with University policy and with explicit UCSB Foundation policy that is in keeping with the overall mission and purpose of the Foundation. University of California Foundations are vital to the voluntary support of the University. Since the completion of the University's internal audit of the UCSB Foundation in 1986, we have taken actions to strengthen Foundation fiscal controls through the development of revised policies for University Foundations and through the development of an overall internal and external audit program for Foundations. The University firmly believes these measures will meet the intent of many of the recommendations in the Auditor General's report.

While we are providing this generally affirmative response now, we must also indicate that we are not in agreement with some of the detail in the report. In some cases, there are

Mr. Thomas Hayes
April 1, 1987
Page Two

statements with which we disagree; in other cases, there is not sufficient detail in the report upon which to base comment, particularly with respect to attributions the report makes to various individuals. With specific regard to the UCSB Foundation, we are not in full agreement with the allegation that restricted and endowment funds were used for improper purposes. However, as noted above, certain improvements in accounting and business practices are being implemented for the UCSB Foundation.

Since the deadline stated in your letter of March 26 for a preliminary UC response to your draft audit report is April 1, the University is prevented from fully coordinating comments and responses with appropriate staff at the campus and the Foundation and with the University's General Counsel. A detailed analysis and response will be prepared and forwarded to your office within the required period following the release of your final report.

With best wishes, I am,

Sincerely,



The image shows a handwritten signature in black ink, appearing to read "David Pierpont Gardner".

David Pierpont Gardner

cc: Acting Chancellor Aldrich
UCSB Foundation Chairman Raznick
Senior Vice President Brady
Vice President Baker
Associate Vice President Pastrone
University Auditor Tuffnell
Director Arditti

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps